Supreme Court, U.S.
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IN THE

Supreme Court of the United States

VERIZON COMMUNICATIONS, INC., *et al.*,
Petitioners,
v.
FEDERAL COMMUNICATIONS COMMISSION AND UNITED STATES OF AMERICA,
Respondents.

APR 9 2001

WORLDCOM, INC., *et al.*,
Petitioners,
v.
VERIZON COMMUNICATIONS, INC., *et al.*,
Respondents.

FEDERAL COMMUNICATIONS COMMISSION AND UNITED STATES OF AMERICA,
Petitioners,
v.
IOWA UTILITIES BOARD, *et al.*,
Respondents.

AT&T CORP.,
Petitioner,
v.
IOWA UTILITIES BOARD, *et al.*,
Respondents.

GENERAL COMMUNICATION, INC.,
Petitioner,
v.
IOWA UTILITIES BOARD, *et al.*,
Respondents.

On Writ of Certiorari to the United States Court of Appeals for the Eighth Circuit

BRIEF ON THE MERITS OF SPRINT CORPORATION IN SUPPORT OF PETITIONERS FEDERAL COMMUNICATIONS COMMISSION AND UNITED STATES OF AMERICA

DAVID P. MURRAY
Counsel of Record
RANDY J. BRANITSKY
KEVIN M. MILLER
WILLKIE FARR & GALLAGHER
1155 21st Street, N.W.
Washington, D.C. 20036
(202) 328-8000
Counsel for Respondent Sprint Corporation

BEST AVAILABLE COPY

WASHINGTON, D. C. 20001

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QUESTIONS PRESENTED

1. Whether the court of appeals erred in holding that Section 252(d)(1) of the Act forecloses the cost methodology adopted by the FCC, which is based on the efficient replacement cost of existing technology, for determining the interconnection rates that new entrants into local telecommunications markets must pay incumbent local telephone companies.

2. Whether Section 251(c)(3) prohibits regulators from requiring that incumbent local telephone companies combine certain previously uncombined network elements when a new entrant requests the combination and agrees to compensate the incumbent for performing that task.

RULE 29.6 STATEMENT

In accordance with Rule 29.6 of the Rules of this Court, Sprint Corporation ("Sprint") states as follows:

> Sprint is a corporation organized for the purpose of engaging in telecommunications and related businesses and is publicly traded under the names Sprint FON and Sprint PCS. Sprint Communications Company L.P. is a wholly-owned subsidiary of Sprint. Deutsche Telekom and France Télécom, both of which have issued public stock, each own approximately a ten percent share of Sprint.

TABLE OF CONTENTS

	Page
QUESTIONS PRESENTED	i
RULE 29.6 STATEMENT	ii
TABLE OF AUTHORITIES	v
PRELIMINARY STATEMENT	1
OPINIONS AND ORDERS BELOW	2
STATEMENT OF THE CASE	2
A. Background	2
B. The Act.	3
C. FCC Regulations.	4
1. Pricing Rules.	5
2. Network Combinations Rule	6
D. Judicial Review of the *Local Competition Order*.	7
1. The First Eighth Circuit Decision.	7
2. *IUB I*	8
3. The Eighth Circuit's Decision On Remand ("*IUB II*").	9
SUMMARY OF ARGUMENT	10
ARGUMENT	12
I. A COST METHODOLOGY BASED ON THE MOST EFFICIENT REPLACEMENT COST OF EXISTING TECHNOLOGY DOES NOT VIOLATE THE ACT.	13
A. Congress Did Not Foreclose A Cost Methodology Based On The Efficient Replacement Cost Of Existing Technology.	13

TABLE OF CONTENTS—Continued

Page

B. The FCC's Efficient Network Configuration Rule Was Reasonable And Entitled To Deference. 17

C. The Eighth Circuit's Holding Is Internally Inconsistent, Economically Unsound, And Will Lead To Unintended Results That Thwart Congress' Goal Of Facilitating Competition..... 20

II. REQUIRING ILECs TO COMBINE NETWORK ELEMENTS SERVES THE PRO-COMPETITIVE PURPOSES OF THE ACT AND DOES NOT VIOLATE THE LANGUAGE OF SECTION 251(c)(3)..... 21

A. This Court Has Previously Held That Section 251(c)(3) Is Ambiguous. 21

B. The Eighth Circuit Has Erred A Second Time In Holding That Section 251(c)(3) Unambiguously Requires New Entrants To Combine UNEs..... 24

C. It Was Reasonable For the FCC To Promulgate A Regulation That Prevents ILECs From Engaging In An "Anticompetitive Practice."..... 25

CONCLUSION 27

TABLE OF AUTHORITIES

CASES — Page

AT&T Corp. v. FCC, 220 F.3d 607 (D.C. Cir. 2000) 16
AT&T Corp. v. Iowa Utils. Bd., 525 U.S. 366 (1999) ..... *passim*
Chevron U.S.A., Inc. v. Natural Res. Def. Council, Inc., 467 U.S. 837 (1984) 12
Duquesne Light Co. v. Barasch, 488 U.S. 299 (1989) 21
Iowa Utils. Bd. v. FCC, 120 F.3d 753 (8th Cir. 1997), *aff'd in part and rev'd in part sub nom. AT&T Corp. v. Iowa Utils. Bd.*, 525 U.S. 366 (1999) 7, 22
Iowa Utils. Bd. v. FCC, 219 F.3d 744 (8th Cir. 2000) ..... *passim*
MCI Telecomms. Corp. v. U S W. Communications, Inc., 204 F.3d 1262 (9th Cir.), *cert. denied*, 121 S. Ct. 504 (2000) 23
Market St. Ry. Co. v. Railroad Comm'n of Cal., 324 U.S. 548 (1945) 16
Missouri ex rel. Southwestern Bell Tel. Co. v. Public Serv. Comm'n, 262 U.S. 276 (1923) 16
Regions Hosp. v. Shalala, 522 U.S. 448 (1998) 12, 13
Southwestern Bell Tel. Co. v. Waller Creek Communications, Inc., 221 F.3d 812 (5th Cir. 2000) 23
Texas Office of Pub. Util. Counsel v. FCC, 183 F.3d 393 (5th Cir. 1999), *cert. granted sub nom. GTE Serv. Corp. v. FCC*, 530 U.S. 1213, *cert. dismissed*, 121 S. Ct. 423 (2000) 5
U S W. Communications, Inc. v. Hix, Civ. No. 97-D-152 (consol.), Order (D. Colo. June 26, 2000) 23

TABLE OF AUTHORITIES—Continued

Page

U S W. Communications, Inc. v. MFS Intelenet, Inc., 193 F.3d 1112 (9th Cir. 1999), *cert. denied*, 120 S. Ct. 2741, *reh'g denied*, 121 S. Ct. 18 (2000) 23

AGENCY DECISIONS

In re Implementation of the Local Competition Provisions in the Telecomms. Act of 1996, 11 F.C.C.R. 15,499 (1996) ..... *passim*

In re Implementation of the Local Competition Provisions of the Telecomms. Act of 1996, 15 F.C.C.R. 3696 (1999) 26

STATUTES

47 U.S.C. § 153(29) 16
47 U.S.C. § 201(b) 4
47 U.S.C. § 251(c)(2)-(4) 4
47 U.S.C. § 251(c)(3) ..... *passim*
47 U.S.C. § 251(d)(1) 4
47 U.S.C. § 252(d)(1) ..... *passim*
47 U.S.C. § 252(d)(1)(A)-(B) 14
47 U.S.C. § 252(d)(1)(A)(i) 4
47 U.S.C. § 252(d)(1)(B) 4

REGULATIONS

47 C.F.R. § 51.315 6
47 C.F.R. § 51.315(b) ..... *passim*
47 C.F.R. § 51.315(c) ..... *passim*
47 C.F.R. § 51.315(c)-(f) ..... *passim*
47 C.F.R. § 51.505(b)(1) ..... *passim*
47 C.F.R. § 51.505(b)(2) 6
47 C.F.R. § 51.505(b)(3) 6
47 C.F.R. § 51.505(c) 6

TABLE OF AUTHORITIES—Continued

CONGRESSIONAL MATERIAL — Page

H.R. Conf. Rep. No. 104-230 (1996) 3, 4

OTHER AUTHORITY

Paul W. Garnett, *Forward-Looking Costing Methodologies and the Supreme Court's Takings Clause Jurisprudence*, 7 CommLaw Conspectus 119 (1999) 7

PRELIMINARY STATEMENT

Pursuant to Supreme Court Rules 24.2 and 25.1, Respondent Sprint Corporation ("Sprint") respectfully submits this Brief on the Merits of Sprint Corporation in Support of Petitioners Federal Communications Commission ("FCC") and United States of America. This brief addresses the following questions:

- Whether the court of appeals erred in holding that 47 U.S.C. § 252(d)(1) (Telecommunications Act of 1996) forecloses the cost methodology adopted by the FCC, which is based on the efficient replacement cost of existing technology, for determining interconnection rates that new entrants into local telecommunications markets must pay incumbent local telephone companies.
- Whether 47 U.S.C. § 252(c)(3) prohibits regulators from requiring that incumbent local telephone companies combine certain previously uncombined network elements when a new entrant requests the combination and agrees to compensate the incumbent for performing that task.

Supreme Court Order List (Jan. 22, 2001) at 3-4.[1]

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[1] The Court also granted the petitions for a writ of certiorari with respect to the following question presented by Verizon Communications, Inc. and the other incumbent local exchange carriers: "Whether the court of appeals erred in holding that neither the Takings Clause nor the Telecommunications Act of 1996 requires incorporation of an incumbent local exchange carrier's 'historical' costs into the rates that it may charge new entrants for access to its network elements." Sprint supports the decision of the court of appeals upholding the FCC's regulations and will file a Respondent's Brief On The Merits, in accordance with the briefing schedule ordered by the Court.

OPINIONS AND ORDERS BELOW

The opinion of the United States Court of Appeals for the Eighth Circuit is reported at 219 F.3d 744 and reprinted in the Petition for a Writ of Certiorari of the FCC and United States of America at 1a-43a.[2] This decision reviewed the First Report and Order, *In re Implementation of the Local Competition Provisions in the Telecommunications Act of 1996*, CC Docket No. 96-98 (Aug. 8, 1996) ("*Local Competition Order*"), and accompanying regulations issued by the FCC. The *Local Competition Order* is reported at 11 F.C.C.R. 15,499. Relevant portions of the *Local Competition Order* are reprinted at FCC Pet. App. 44a-103a. The regulations are codified at 47 C.F.R. §§ 51.1-51.809. Relevant portions of the codified regulations are reprinted at FCC Pet. App. 126a-131a. The *Local Competition Order* and codified regulations implemented the Telecommunications Act of 1996 ("Act"), Pub. L. No. 104-104, 110 Stat. 56 (codified at 47 U.S.C. §§ 151-276). Relevant portions of the Act are reprinted at FCC Pet. App. 104a-125a.

STATEMENT OF THE CASE

A. Background.

Unlike many of the private parties participating in these proceedings, Sprint has *both* local and long distance operations. The "long distance side" of Sprint, like other new entrants, is interested in obtaining nondiscriminatory access to the networks of the incumbent local exchange carrier ("incumbent LEC" or "ILEC") at rates that will facilitate Sprint's ability to compete for business in the local telephone markets. The "local side" of Sprint, like other ILECs, is interested in ensuring that its rights and obligations under the

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[2] The Court has agreed to the submission of a deferred Joint Appendix. For purposes of this brief, Sprint cites to previously reproduced excerpts from the Petition for a Writ of Certiorari of the FCC and United States of America ("FCC Pet. App. _").

Act are rationally and uniformly elucidated, that it is fairly compensated for sharing its local networks with new entrants, and that its operations are not unduly burdened. Sprint has participated both as a new entrant and as an ILEC in state-regulated arbitrations pursuant to Section 252 of the Act. These experiences have given Sprint a balanced perspective on the challenges of opening local telephone markets to competition while satisfying the divergent interests of new entrants and ILECs.

Sprint believes that the vacated FCC regulations strike the proper balance in implementing the Act's pro-competitive objectives. The vacated price regulation establishes a forward-looking, long-run methodology for pricing unbundled network elements ("UNEs") based on "the most efficient telecommunications technology currently available and the lowest cost network configuration, given the existing location of the incumbent LEC's wire centers." 47 C.F.R. § 51.505(b)(1) ("Rule 505(b)(1)") (FCC Pet. App. 128a). This methodology attempts to replicate prices that would prevail in a competitive environment while ensuring that the ILEC is compensated for the use of its network elements at prices reflecting what it would cost to replace the elements today. The vacated network combinations regulation requires that ILECs "perform the functions necessary to combine unbundled network elements in any manner, even if those elements are not ordinarily combined in the incumbent LEC's network." *Id.* § 51.315(c) ("Rule 315(c)") (FCC Pet. App. 126a). This requirement is intended to ensure that new entrants have efficient and meaningful access to UNEs in order to offer competitive local services.

B. The Act.

The Act seeks to transform state-sanctioned local monopolies into fully competitive markets on a national scale. *See* H.R. Conf. Rep. No. 104-230, at 113 (1996) (the primary goal of the Act is to increase competition in both

local and long distance telephone markets as swiftly as possible). Congress recognized the practical and economic impediments that new entrants would face if forced to replicate all of the ILEC's existing local network infrastructure. Congress therefore established comprehensive requirements "intended to facilitate market entry." *AT&T Corp. v. Iowa Utils. Bd.*, 525 U.S. 366, 371 (1999) ("*IUB I*"). "Foremost" among them is the ILEC's "obligation under [Section 251(c)] to share its network with competitors." *Id.* The Act provides three complementary avenues for new entrants to obtain access to an ILEC's network: (i) interconnection with an ILEC's existing local network; (ii) leasing UNEs of the ILEC's network, either alone or in combination; and (iii) reselling the ILEC's services. 47 U.S.C. § 251(c)(2)-(4) (FCC Pet. App. 106a-107a).

Section 251(c)(3), which is at issue here, imposes a duty on ILECs to provide "nondiscriminatory" access to UNEs. *Id.* § 251(c)(3) (FCC Pet. App. 106a-107a). New entrants may use the leased UNEs, alone or in combination with the new entrant's own network facilities, to offer new and different competitive local services. ILECs are to receive "just [and] reasonable" compensation for leasing UNEs, "based on the cost . . . of providing" the element, including a "reasonable profit." *Id.* §§ 251(c)(3), 252(d)(1)(A)(i), (B) (FCC Pet. App. 106a-107a, 119a).

C. FCC Regulations.

Congress expressly delegated to the FCC the authority to promulgate rules to implement the Act's requirements. *Id.* §§ 201(b), 251(d)(1) (FCC Pet. App. 108a). The Act sets few limits on the FCC's exercise of this authority. As this Court has recognized, the key provisions of the Act are subject to multiple interpretations and Congress was "well aware" that these ambiguities would be resolved by the FCC. *IUB I*, 525 U.S. at 397. The FCC adopted its local competition rules on

August 8, 1996. *Local Competition Order*, 11 F.C.C.R. at 15,499.

1. Pricing Rules.

The FCC promulgated a cost methodology for establishing UNE rates that attempts to replicate conditions in a competitive market, while fairly compensating ILECs for the "cost" of providing the UNE. The FCC concluded that a "forward-looking long-run economic cost" approach would best accomplish these objectives. *Id.* at 15,844 (¶ 672) (FCC Pet. App. 61a-62a). A forward-looking approach measures the cost today to build an efficient local network with the same capabilities. *Id.* at 15,857-58 (¶ 705) (FCC Pet. App. 86a-87a). New entrants, which build new facilities using the lowest cost, most efficient technology available, set prices on that basis. In response to this competition, ILECs, likewise would replace existing facilities using the lowest cost, most efficient technology available.

Forward-looking cost methods have been widely accepted in the professional literature, were implemented by several state utility commissions prior to passage of the Act, *see id.* at 15,817-19 & nn.1508-14 (¶ 631) (FCC Pet. App. 56a-58a), and were used by numerous other regulatory agencies in analogous contexts, *see Texas Office of Pub. Util. Counsel v. FCC*, 183 F.3d 393, 411-12 & nn.12 & 13 (5th Cir. 1999) (citing examples of agencies adopting forward-looking, most efficient technology methodologies to encourage competition), *cert. granted sub nom. GTE Serv. Corp. v. FCC*, 530 U.S. 1213, *cert. dismissed*, 121 S. Ct. 423 (2000). The particular forward-looking approach adopted by the FCC is called "Total Element Long Run Incremental Cost" or "TELRIC." TELRIC ensures that ILECs recover the full forward-looking cost of leased UNEs by measuring the long-run, incremental cost of the network element based on: (i) the use of the "most efficient telecommunications technology currently available and the lowest cost network configuration,

given the existing location of the incumbent LEC's wire centers," 47 C.F.R. § 51.505(b)(1) (FCC Pet. App. 128a); (ii) the cost of capital, thus allowing ILECs to recover normal economic profit, *id.* § 51.505(b)(2) (FCC Pet. App. 128a); and (iii) the useful life of the element, as measured by its economic depreciation rate, *id.* § 51.505(b)(3) (FCC Pet. App. 128a). In addition, TELRIC allows for a reasonable share of joint and common costs. *Id.* § 51.505(c) (FCC Pet. App. 129a).

2. Network Combinations Rule.

The FCC promulgated a network combinations rule to implement the requirement in Section 251(c)(3) that ILECs provide nondiscriminatory access to UNEs in a manner that allows new entrants to use those elements to offer competitive local services to customers. *Id.* § 51.315 (FCC Pet. App. 126a-127a). The network combinations rule establishes two related requirements. 47 C.F.R. § 51.315(b) ("Rule 315(b)") prohibits the ILEC from separating elements already combined in its network. Rule 315(c) requires the ILEC to combine, at a new entrant's request, elements that are not already combined to the extent technically feasible. The FCC determined that "in practice it would be impossible for new entrants that lack facilities and information about the incumbent's network to combine unbundled elements from the incumbents' network without the assistance of the incumbent." *Local Competition Order*, 11 F.C.C.R. at 15,647 (¶ 293) (FCC Pet. App. 45a). The FCC found that as a result of these "practical difficulties," requesting carriers "would be seriously and unfairly inhibited in their ability to use unbundled elements to enter local markets," if ILECs were not required to combine UNEs upon request. *Id.* (¶¶ 293-294) (FCC Pet. App. 45a-46a).

D. Judicial Review of the *Local Competition Order*.

1. The First Eighth Circuit Decision.

Challenges to the *Local Competition Order* were consolidated in the Eighth Circuit and first decided in 1997. Of relevance here, the Eighth Circuit invalidated the FCC's pricing rules—including Rule 505(b)(1)—holding that the Act gives state public utility commissions, not the FCC, general jurisdiction to interpret and implement the Act's pricing provisions. *Iowa Utils. Bd. v. FCC*, 120 F.3d 753, 794-800 (8th Cir. 1997), *aff'd in part and rev'd in part sub nom. AT&T Corp. v. Iowa Utils. Bd.*, 525 U.S. 366 (1999).[3] The Eighth Circuit also invalidated Rule 315(b)-(f)—the network combinations rule—on the ground that it violated the plain terms of Section 251(c)(3) of the Act. *Id.* at 813. According to the Eighth Circuit, "Section 251(c)(3) requires an incumbent LEC to provide access to the elements of its network only on an unbundled (as opposed to a combined) basis." *Id.* The Eighth Circuit believed that the statute "*unambiguously* indicates that requesting carriers will combine the unbundled elements themselves" because "the Act requires incumbent LECs to provide elements in a manner that enables the competing carriers to combine them." *Id.* (emphasis added). The Eighth Circuit thus rejected the FCC's interpretation of Section 251(c)(3), holding that the statutory "language [cannot] be read to levy a duty on the incumbent LECs to do the actual combining of elements." *Id.*

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[3] During the period when the FCC's pricing rules were vacated on jurisdictional grounds, the overwhelming majority of state commissions independently chose to adopt the TELRIC methodology. *See* Paul W. Garnett, *Forward-Looking Costing Methodologies and the Supreme Court's Takings Clause Jurisprudence*, 7 CommLaw Conspectus 119, 132 (1999) (at least 35 states announced their intent to adopt TELRIC).

2. *IUB I.*

In *IUB I*, this Court described the paramount role Congress gave the FCC to interpret and implement the Act and the limited circumstances under which federal courts may override the decisions of the FCC. The Court stated as follows:

> It would be gross understatement to say that the Telecommunications Act of 1996 is not a model of clarity. It is in many important respects a model of ambiguity or indeed even self-contradiction. . . . The 1996 Act can be read to grant . . . "most promiscuous rights" to the FCC vis-à-vis the state commissions and to competing carriers vis-à-vis the incumbents—and the [FCC] has chosen in some instances to read it that way. But Congress is well aware that *the ambiguities it chooses to produce in a statute will be resolved by the implementing agency*. (citation omitted). We can only enforce the *clear limits* that the 1996 Act contains . . . .

IUB I, 525 U.S. at 397 (emphasis added).

This Court reversed numerous parts of the Eighth Circuit's decision. Among other things, the Court held that Section 201(b) of the Act gives the FCC jurisdiction to adopt rules to implement all of the Act's local competition provisions. *Id.* at 377-86. The Court reversed the Eighth Circuit's ruling that the FCC lacked the statutory authority to establish national pricing rules, reinstated the FCC's pricing rules, and remanded so that the Eighth Circuit could review the substantive challenges to those rules. *Id.* at 377-78.

This Court also addressed one aspect of the FCC's network combinations rule, Rule 315(b), which prohibits ILECs from separating requested network elements that the ILEC ordinarily combines. The Court rejected the Eighth Circuit's "plain language" argument, holding that Section 251(c)(3) is ambiguous. *Id.* at 395. The Court held that the term "unbundled" in Section 251(c)(3) could refer to separately

priced assets as distinguished from "physically separated" assets. *Id.* at 394. Although the Act contemplates that elements may be requested and provided in discrete pieces, the Court held that the Act "does not say, or even remotely imply, that elements *must* be provided only in this fashion and never in combined form." *Id.* (emphasis in original). The Court further found Rule 315(b) to be "entirely rational, finding its basis in § 251(c)(3)'s nondiscrimination requirement." *Id.* at 395. The Court accepted the FCC's explanation that the only reason an ILEC would disconnect previously connected elements over the objection of the new entrant would be to impose wasteful reconnection costs. The Court held that "[i]t is well within the bounds of the reasonable for the [FCC] to opt in favor of ensuring against an anticompetitive practice." *Id.*

3. The Eighth Circuit's Decision On Remand ("*IUB II*").

In July 2000, the Eighth Circuit issued its decision on remand. The Eighth Circuit found that the term "cost" in § 252(d)(1) is "ambiguous" and that the FCC was therefore authorized to interpret the term to allow for a forward-looking cost model. *Iowa Utils. Bd. v. FCC*, 219 F.3d 744, 751-52 (8th Cir. 2000) ("*IUB II*") (FCC Pet. App. 11a). The Eighth Circuit further held that the FCC's "use of a forward-looking cost methodology was reasonable," noting that the FCC had explained its reasoning "in detail." *Id.* at 752 (FCC Pet. App. 12a).[4]

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[4] The court also held that the doctrine of constitutional avoidance did not require the FCC to use a historical cost model, citing well established law that "a takings claims cannot be based on the ratemaking methodology, but rather it must be based on the rate itself." *IUB II*, 219 F.3d at 754 (FCC Pet. App. 17a). The court thus rejected as premature the incumbents' Takings Clause challenge to the TELRIC methodology. *Id.* (FCC Pet. App. 17a-18a)

Despite affirming the use of a forward-looking price methodology, the Eighth Circuit invalidated a key component of the FCC's methodology that measures forward-looking costs "based on the use of the most efficient telecommunications technology currently available and the lowest cost network configuration." *Id.* at 749-50 (FCC Pet. App. 8a). The Eighth Circuit held that because Section 252(d)(1) states that an ILEC may charge a just and reasonable rate "based on the cost . . . of providing *the* . . . network element," Rule 505(b)(1) is contrary to "the plain meaning" of the statute. *Id.* at 750 (FCC Pet. App. 8a) (emphasis in original). According to the Eighth Circuit, Congress' use of the definite article "the" in Section 252(d)(1) necessarily refers to the actual facilities deployed by the ILEC and thus precludes a forward-looking methodology that calculates costs by reference to the most efficient technology and design choices. *Id.*

The Eighth Circuit also reaffirmed its prior invalidation of Rule 315(c)-(f), notwithstanding this Court's reinstatement of Rule 315(b). *Id.* at 759 (FCC Pet. App. 27a). The Eighth Circuit again held that Congress, in the second sentence of Section 251(c)(3), "has directly spoken on the issue of who shall combine previously uncombined network elements. It is the requesting carriers who shall 'combine such elements.'" *Id.* (FCC Pet. App. 28a-29a).

SUMMARY OF ARGUMENT

In *IUB I*, this Court noted that the Act is in many respects ambiguous and held that the FCC is entitled to deference in interpreting and implementing its local competition provisions. The Eighth Circuit on remand refused to accord such deference to the FCC's determinations that forward-looking costs should be measured based upon a "least cost, most efficient technology" (Rule 505(b)(1)), and that ILECs should be required to combine network elements not ordinarily combined in their networks upon request (Rule

315(c)-(f)). The Eighth Circuit reasoned that both challenged regulations violated the "plain meaning" of the Act. These holdings rest on overly restrictive readings of the Act that will thwart, rather than promote, local telephone competition.

Rule 505(b)(1)'s "efficient network configuration" requirement helps to ensure that prices for UNEs are set at rates that replicate a competitive market, compensating the ILEC for what it would cost to replace the elements in today's market. As an organization with both long distance and local operations, Sprint believes that Rule 505(b)(1) strikes a fair and reasonable balance and is consistent with the pro-competitive purposes of the Act. The Eighth Circuit erroneously believed the statutory language in Section 252 (d)(1) requiring that UNE rates be based on the cost of providing "the" interconnection or network element unambiguously means that rates may only be based on the cost of the ILEC's existing network. This holding compensates ILECs based on the cost of replacing network equipment with the very same equipment, even if no rational firm would deploy such technology in a competitive marketplace. Such an outcome is unsatisfactory to Sprint's entire organization. If costs are set too high, it will preclude effective competition. If costs are set too low, it will send false signals to potential new entrants concerning efficient entry levels. Rule 505(b)(1) helps to avoid these adverse results by setting costs in a manner that most closely simulates those of a competitive market.

Rule 315(c)-(f)'s combinations requirement ensures that new entrants will have nondiscriminatory access to UNEs in a manner that permits them to provide competitive services. The Eighth Circuit erroneously believed that the statutory language "unambiguously" requires new entrants to "do the combining themselves." This Court has already rejected that interpretation of Section 251(c)(3), which, as the FCC found, would effectively preclude many new entrants from using UNEs to offer competitive services. Because an ILEC

maintains control over its own network, it typically would be more efficient and less costly for the ILEC to perform the functions necessary to combine UNEs. In some instances, it may be practically impossible for a new entrant to combine UNEs located within the network of the ILEC. Under the FCC's rule, the ILEC would be compensated at cost-based rates for performing the functions necessary to combine the elements. Sprint knows of no reason why an ILEC would refuse to do so other than to impose unnecessary burdens and costs on the new entrant.

The Act is designed to benefit consumers by bringing rapid competition to local telephone services. The regulations vacated by the Eighth Circuit are rational measures that the FCC deemed necessary to carry out Congress' mandate. The regulations should be restored.

ARGUMENT

This Court's review of the challenged FCC regulations should be highly deferential. Under the relevant standard, the FCC's implementing regulations should be upheld unless "Congress has . . . addressed the precise question at issue" and unambiguously foreclosed the FCC's choice, or the agency's reasoning was arbitrary. *Chevron U.S.A., Inc. v. Natural Res. Def. Council, Inc.*, 467 U.S. 837, 842-43, 845 (1984) ("*Chevron*"); *IUB I*, 525 U.S. at 397 (pursuant to *Chevron*, courts are only to "enforce the clear limits that the [Telecommunications Act of 1996] contains"). In making these determinations, "considerable weight should be accorded to an executive department's construction of a statutory scheme it is entrusted to administer." *Chevron*, 467 U.S. at 844. "If the agency's reading [of a statute] fills a gap or defines a term in a reasonable way in light of the Legislature's design, we give that reading controlling weight, even if it is not the answer 'the court would have reached if the question initially had arisen in a judicial proceeding.'"

Regions Hosp. v. Shalala, 522 U.S. 448, 457 (1998) (quoting *Chevron*, 467 U.S. at 843 n.11).

The Act, as this Court noted, "is in many important respects a model of ambiguity or indeed even self-contradiction" that imposes few restraints on the FCC's exercise of its implementing authority. *See IUB I*, 525 U.S. at 397 (the Act grants "most promiscuous rights" to the FCC); *see also id.* ("Congress is well aware that the ambiguities it chooses to produce in a statute will be resolved by the implementing agency."). The Eighth Circuit acknowledged that the Act contained ambiguities and that the responsibility for resolving them belongs to the FCC, not the courts. *IUB II*, 219 F.3d at 752 (FCC Pet. App. 11a-12a). Even so, the Eighth Circuit invalidated the pricing and network combinations rules based on strained readings of the "plain language" of the statute, thereby improperly depriving the expert agency of its authority to implement the Act's objectives.

I. A COST METHODOLOGY BASED ON THE MOST EFFICIENT REPLACEMENT COST OF EXISTING TECHNOLOGY DOES NOT VIOLATE THE ACT.

A. Congress Did Not Foreclose A Cost Methodology Based On The Efficient Replacement Cost Of Existing Technology.

The Eighth Circuit recognized that "the term 'cost,' as it is used in [Section 252(d)(1)], is ambiguous and that Congress has not spoken directly on the meaning of the word in this context." *Id.* at 751 (FCC Pet. App. 11a). The Eighth Circuit thus held that "the FCC's use of a forward-looking cost methodology was reasonable," noting that in the *Local Competition Order*, "the FCC explained in detail its reason for selecting a forward-looking cost methodology to implement the new competitive goals of the Act." *Id.* at 752 (FCC Pet. App. 12a).

Despite correctly holding that Section 252(d)(1) is ambiguous with respect to what is meant by "cost," the Eighth Circuit erroneously concluded that Section 252(d)(1) *unambiguously* precludes the FCC from adopting a methodology that measures that cost by reference to an efficient network. "It is clear from the language of the statute," the court held, "that Congress intended the rates to be 'based on the cost . . . of providing *the* interconnection or network element' . . . not the cost some imaginary carrier would incur by providing the newest, most efficient, and least cost substitute for the actual item or element which will be furnished." *Id.* at 750 (FCC Pet. App. 8a-9a) (emphasis in original). The court then detailed its understanding of what the Act mandates: "The new entrant competitor, in effect, piggybacks on the ILEC's existing facilities and equipment. It is the cost to the ILEC of providing that ride on those facilities that the statute permits the ILEC to recoup." *Id.* at 751 (FCC Pet. App. 9a). Accordingly, the Eighth Circuit concluded, Section 252(d)(1) requires that rates be calculated based on the forward-looking cost of the ILEC's *existing* network.

The Eighth Circuit misinterpreted Section 252(d)(1). The provision states, in pertinent part, that "the just and reasonable rate for the interconnection of facilities and equipment . . . and the just and reasonable rate for network elements" be based on the cost "of providing *the interconnection or network element* (whichever is applicable), and [] nondiscriminatory, and [] may include a reasonable profit." 47 U.S.C. § 252(d)(1)(A)-(B) (FCC Pet. App. 118a-119a) (emphasis added). The use of "the" before the phrase "interconnection or network element" merely identifies the thing (interconnection or network element) to which the cost-based requirement applies. "The" does not carry—and should not be read necessarily to imply—some greater connotation that unambiguously limits the FCC's ability to

determine a basic component of its methodology for determining UNE "cost."

A cost methodology based on the most efficient replacement cost of existing network elements comports with the Eighth Circuit's conclusion that Section 252(d)(1) mandates that rates be based on the cost of providing the actual network element used by a new entrant. A long-run methodology assumes a period long enough that all costs are variable. That is to say, the very nature of such a methodology assumes that all plant and equipment can be replaced. If all plant and equipment can be replaced, any rational firm would do so in the most efficient manner. The long-term, forward-looking cost of the original piece of equipment is the cost of the efficient, new equipment needed to replace it.

Rule 505(b)(1) thus correctly measures the cost of providing the actual network element or interconnection by asking what cost the ILEC or any other carrier would bear in the marketplace *today* to replace the functions at issue with efficient substitutes currently available on the market that could be used consistently with the location of the ILEC's existing wire centers. Although the Eighth Circuit agreed that Section 252(d)(1) could be reasonably interpreted to permit a forward-looking cost methodology, the court's strained emphasis on the word "the" in the provision precludes a key component that gives rational effect to that methodology. Given that the Act's pricing provisions "give rate-setting commissions broad methodological leeway; [and] say little about the 'method employed' to determine a particular rate," *see IUB I*, 525 U.S. at 423 (Breyer, J., dissenting in part), the FCC's use of the most efficient replacement cost in Rule 505(b)(1), as a component of its TELRIC methodology, should be given controlling weight.

The Eighth Circuit misconstrued the statutory language in another respect as well. The Eighth Circuit incorrectly presumed that, in considering the costs of efficient

substitutes, regulators are determining the forward-looking cost of something other than the elements whose functions the new entrant seeks to obtain. The forward-looking cost of any asset necessarily turns on the cost of replacing its *functions* with currently available, efficient substitutes. The term "element" describes, at an appropriately high level of generality, the *class* of facilities (or "features, functions, and capabilities") associated with particular tasks within the network. 47 U.S.C. § 153(29); *IUB I*, 525 U.S. at 387. For example, fiber wires and copper wires, despite their technological differences, can both be used to provide the loop element. *Cf. AT&T Corp. v. FCC*, 220 F.3d 607, 618-19 (D.C. Cir. 2000) (reviewing relative merits of using optical fiber versus copper to determine forward-looking cost of loop element). Similarly, analog switches and digital switches can both be used to provide the switching element. *Local Competition Order*, 11 F.C.C.R. at 15,691, 15,706 (¶¶ 380, 412). The Eighth Circuit's decision confines the term "element" to individual pieces of equipment. Consequently, the Eighth Circuit believed that the forward-looking inquiry should turn on the cost of replacing an ILEC's existing facilities in every physical particular—rather than the *function* of those facilities—regardless of whether a rational actor would construct such facilities in today's market. Nothing in the language of Section 252(d)(1) remotely compels the adoption of that long-discredited methodological approach. *Id.* at 15,848 (¶ 684) (FCC Pet. App. 70a) (recognizing that such an approach could produce rates "that reflect inefficient or obsolete network design and technology"); *Missouri ex rel. Southwestern Bell Tel. Co. v. Public Serv. Comm'n*, 262 U.S. 276, 312 (1923) (Brandeis, J., concurring in the judgment) (disparaging, as the *least* appropriate cost methodology, an inquiry into "what it would cost to reproduce the identical property"); *Market St. Ry. Co. v. Railroad Comm'n of Cal.*, 324 U.S. 548, 567 (1945) (in rate-setting contexts it never has been held that state

commissions must "fix rates on the present reproduction value of something no one would presently want to reproduce").

B. The FCC's Efficient Network Configuration Rule Was Reasonable And Entitled To Deference.

The FCC adopted TELRIC because, in its view, a methodology based on forward-looking economic costs should "drive retail prices to their competitive levels" by setting costs at levels firms would face in a competitive market. *Local Competition Order*, 11 F.C.C.R. at 15,846 (¶ 679) (FCC Pet. App. 66a). This "give[s] appropriate signals to producers and consumers and ensure[s] efficient entry and utilization of the telecommunications infrastructure." *Id.* at 15,817 (¶ 630) (FCC Pet. App. 55a). The FCC carefully evaluated alternatives to its TELRIC methodology, as well as more general objections to the use of forward-looking pricing. The FCC also considered several variants of forward-looking pricing before determining that TELRIC is the most effective and fair means to implement the Act's pro-competitive goals.

In particular, the FCC rejected pricing based on the "historical" or "embedded" costs reflected on the ILECs' accounting books. The FCC recognized that these costs could be either higher or lower than forward-looking costs. *Id.* at 15,857-58 (¶ 705) (FCC Pet. App. 86a-87a). The FCC reasoned that the use of historical costs in determining the rates paid by new entrants would force competitors to pay for the existing inefficiency of the ILECs' networks and would not "ensure the efficient investment decisions and competitive entry contemplated by the [] Act." *Id.* at 15,858 (¶ 705) (FCC Pet. App. 87a). The FCC thus concluded that historical cost pricing would frustrate the Act's competitive objectives. *Id.* at 15,857-60 (¶¶ 704-711) (FCC Pet. App. 84a-91a).

The FCC likewise declined to establish a formula that would estimate the "forward-looking" cost of the ILEC's existing network. *Id.* at 15,848 (¶ 684) (FCC Pet. App. 70a). This approach appears to most closely resemble the Eighth Circuit's decision. Because this approach would allow ILECs to recover costs "that reflect inefficient or obsolete network design and technology," the FCC found it would be "essentially an embedded cost methodology." *Id.* In asking what it would cost to replace the functions that make an asset valuable, the FCC noted that a forward-looking methodology requires an inquiry into currently available substitutes—including assets that perform the same functions as the original asset, but that do not resemble the asset in all respects—because they embody more efficient technology than does the original asset. *Id.* at 15,848-49 (¶¶ 683-685) (FCC Pet. App. 69a-71a).

The FCC did not, as the Eighth Circuit wrongly contends, base its TELRIC methodology on "some state of the art presently available technology ideally configured but neither deployed by the ILEC nor to be used by the competitor." *See IUB II*, 219 F.3d at 751 (FCC Pet. App. 10a). The FCC noted that "[p]rices based on the least-cost, most efficient network design and technology replicate conditions in a highly competitive marketplace by not basing prices on existing network design and investments unless they represent the least-cost systems available for purchase . . . ." *Local Competition Order*, 11 F.C.C.R. at 15,848 (¶ 683) (FCC Pet. App. 69a). Even so, the FCC expressly declined to adopt a forward-looking methodology "based on the most efficient network architecture, sizing, technology, and operating decisions that are operationally feasible and currently available to the industry." *Id.* The FCC instead established a methodology "based on costs similar to those incurred by incumbents." *Id.* at 15,846 (¶ 679) (FCC Pet. App. 66a-67a). The FCC accomplished this by determining that TELRIC should take as given the ILEC's existing wire centers. *Id.* at

15,848-49 (¶ 685) (FCC Pet. App. 70a-71a). That pragmatic limitation has considerable significance for determining the rates that ILECs may charge, because it confines the inquiry to efficient alternatives that are compatible with the most basic geographic design of the existing network. By basing prices on efficient new technology that is compatible with the ILEC's actual wire center locations, the FCC's approach mitigates ILECs' concerns that a forward-looking pricing methodology ignores their existing infrastructure. In the FCC's words, "[t]his benchmark of forward-looking cost and existing network design *most closely represents the incremental costs that incumbents actually expect to incur in making network elements available to new entrants*." *Id.* at 15,849 (¶ 685) (FCC Pet. App. 70a-71a) (emphasis added). The FCC further determined that this limitation, by encouraging new entrants to reduce costs "by designing more efficient network configurations," would put to rest any concern that the use of a forward-looking cost methodology would leave new entrants with insufficient incentives to construct their own facilities. *Id.* (FCC Pet. App. 71a).

TELRIC thus encourages and facilitates efficient market entry. If the rates for network elements are set below forward-looking cost, new entrants might be deterred from building competing facilities. Moreover, some new entrants would be induced to enter using network elements where it would not otherwise be economically efficient for them to do so. If the rates for network elements are set too high, however, competitive entry may never occur. That is because it is unlikely that new entrants will ever build completely ubiquitous local networks and consequently must rely, at least in part, on leased elements. Because new entrants would be unable to price their retail services at competitive levels, they would decline to enter the market at all. By designing a forward-looking cost methodology that simulates a competitive market, the FCC sought to ensure that the rates eventually produced by that methodology would encourage

new entrants to build competing facilities without stifling competition from the outset. *Id.* at 15,848-49 (¶ 685) (FCC Pet. App. 70a-71a). Rule 505(b)(1)'s network configuration requirement is a reasonable and necessary component of that methodology. The Rule should be reinstated under *Chevron*.

C. The Eighth Circuit's Holding Is Internally Inconsistent, Economically Unsound, And Will Lead To Unintended Results That Thwart Congress' Goal Of Facilitating Competition.

Contrary to the Eighth Circuit's suggestion, the more appropriate way to "deal[] with reality" in determining the forward-looking costs of network elements is to take current available alternatives into account, rather than ignore them. In competitive markets, the price that a firm would pay to lease particular facilities varies with the cost of obtaining the function of the facilities through some other means, including through the use of more efficient substitutes. A firm would not arbitrarily blind itself to the availability of such substitutes. Taking those substitutes fully into account is not "fantasizing about what might be," as the Eighth Circuit wrongly believed, but is a routine part of any sensible inquiry into the current value of an asset. Indeed, it would be irrational, in conducting such an inquiry, to *omit* consideration of the effective substitutes altogether and to proceed on the assumption that technology has frozen in time and has no bearing on replacement costs.

Moreover, the Eighth Circuit's holding undermines Congress' goal of creating competitive market conditions as quickly as possible—a goal the Eighth Circuit itself recognized was advanced by a forward-looking cost methodology. If new competitors could enter the local market immediately by building ubiquitous networks, they would set prices based on forward-looking costs using the latest and most efficient technologies, and ILECs would be forced to follow suit. TELRIC achieves a similar result in the

short term by allowing new entrants to lease parts of the existing network at their competitive market value. *See Duquesne Light Co. v. Barasch*, 488 U.S. 299, 308 (1989) (forward-looking costs "mimic[] the operation of the competitive market"). The FCC's approach encourages the "*efficient* entry and utilization of the telecommunications infrastructure," *Local Competition Order*, 11 F.C.C.R. at 15,817 (¶ 630) (FCC Pet. App. 55a) (emphasis added), while sending the correct signals for entry, investment and innovation to producers, investors and consumers. By contrast, the Eighth Circuit's decision, which results in a cost methodology that attempts to calculate the cost to reproduce the identical equipment in the ILEC's network at today's cost, even if such a network would never be built today because the technology deployed is obsolete and inefficient, is essentially an embedded cost methodology.

Finally, the Eighth Circuit's holding could lead to unexpected results. The court's conclusion that "it is the cost to the ILEC of carrying the extra burden of the competitor's traffic that Congress entitled the ILECs to recover" suggests that the Act mandates a pure incremental cost methodology. This approach could result in a sweeping downward departure from the prices arrived at under TELRIC, providing inadequate compensation to ILECs and artificial incentives for new entrants to compete solely by leasing UNEs instead of establishing their own networks.

II. REQUIRING ILECs TO COMBINE NETWORK ELEMENTS SERVES THE PRO-COMPETITIVE PURPOSES OF THE ACT AND DOES NOT VIOLATE THE LANGUAGE OF SECTION 251(c)(3).

A. This Court Has Previously Held That Section 251(c)(3) Is Ambiguous.

Section 251(c)(3) imposes on ILECs:

> The duty to provide, to any requesting telecommunications carrier for the provision of a telecommunications service, nondiscriminatory access to network elements on an unbundled basis .... An incumbent local exchange carrier shall provide such unbundled network elements in a manner that allows requesting carriers to combine such elements in order to provide such telecommunications service.

47 U.S.C. § 251(c)(3) (FCC Pet. App. 106a-107a).

To implement this statutory provision, the FCC promulgated regulations that prohibited ILECs from separating already combined network elements requested by new entrants, 47 C.F.R. § 51.315(b) (FCC Pet. App. 126a), and that required ILECs to combine network elements that are not "ordinarily combined in the incumbent's network at a new entrant's request," *see id.* § 51.315(c)-(f) (FCC Pet. App. 126a-127a). The first time the Eighth Circuit reviewed the FCC's network combinations rule, it held that Section 251(c)(3) "requires an incumbent LEC to provide access to the elements of its network *only* on an unbundled (as opposed to a combined) basis" and "*unambiguously* indicates that requesting carriers will combine the unbundled elements themselves." *Iowa Utils. Bd. v. FCC*, 120 F.3d at 813 (emphasis added).

In *IUB I*, this Court rejected the Eighth Circuit's interpretation of Section 251(c)(3), holding that the statute was *ambiguous*. This Court held that Section 251(c)(3) "does not say, or even remotely imply, that elements *must* be provided only [in discrete pieces] and never in combined form." *IUB I*, 525 U.S. at 394 (emphasis in original). The FCC's interpretation of "unbundled," this Court found, matched the only dictionary interpretation of that word: "'to give separate prices for equipment and supporting services.'" *Id.* (citation omitted). The Court thus deferred to the FCC's interpretation of Section 251(c)(3), finding that "[i]t was

entirely reasonable for the [FCC] to find that the text does not command [the] conclusion" that the provision "contemplates the leasing of network elements in discrete pieces." *Id.* Moreover, the Court found that "[i]n the absence of Rule 315(b) . . . incumbents could impose wasteful costs on [new entrants]." *Id.* at 395. The Court held that the FCC was right to prohibit such "an anticompetitive practice." *Id.* at 394-95.

In light of this Court's decision, a number of federal courts have held that state commissions may impose terms in interconnection agreements requiring ILECs to combine previously uncombined UNEs. *See U S W. Communications, Inc. v. MFS Intelenet, Inc.*, 193 F.3d 1112, 1121 (9th Cir. 1999) ("It also necessarily follows from [this Court's decision in *IUB I*] that requiring [the ILEC] to combine unbundled network elements is not inconsistent with the Act: the . . . combination provision does not conflict with the Act because the Act does not say or imply that network elements may only be leased in discrete parts."), *cert. denied*, 120 S. Ct. 2741, *reh'g denied*, 121 S. Ct. 18 (2000); *MCI Telecomms. Corp. v. U S W. Communications, Inc.*, 204 F.3d 1262, 1268 (9th Cir.) ("The Supreme Court's interpretation of the Act makes absolutely clear that" a provision requiring combinations does not violate the Act.), *cert. denied*, 121 S. Ct. 504 (2000); *Southwestern Bell Tel. Co. v. Waller Creek Communications, Inc.*, 221 F.3d 812, 821 (5th Cir. 2000) ("There is nothing 'illegal' about the provision requiring [the ILEC] to combine network elements for [the new entrant]" because "[n]othing in the Telecommunications Act forbids such combinations."); *U S W. Communications, Inc. v. Hix*, Civ. No. 97-D-152 (consol.), Order at 13-14 (D. Colo. June 26, 2000) (interconnection agreement provisions "that require [the ILEC] to combine network elements at the request of new entrants are fully consistent with Section 251(c)(3) of the Act, as dispositively interpreted by the Supreme Court"). These courts upheld provisions requiring ILECs to combine UNEs as consistent with the Act and rejected the Eighth Circuit's

conclusion that Section 251(c)(3) forecloses such a requirement.

B. The Eighth Circuit Has Erred A Second Time In Holding That Section 251(c)(3) Unambiguously Requires New Entrants To Combine UNEs.

On remand, the Eighth Circuit reaffirmed its earlier decision to invalidate Rule 315(c)-(f) based on the same "plain language" interpretation of Section 251(c)(3) that this Court rejected in *IUB I*. *IUB II*, 219 F.3d at 759 (FCC Pet. App. 27a). The Eighth Circuit focused on the phrase "in a manner that allows requesting carriers to combine" in concluding that the statute unambiguously requires new entrants to do the combining. *Id.* (FCC Pet. App. 28a-29a). This holding ignores the important implications of the Court's *IUB I* decision. In restoring Rule 315(b), this Court implicitly rejected an interpretation of Section 251(c)(3) that precludes ILECs from being required to provide UNE combinations. Rule 315(b) prevents ILECs from separating already combined UNEs, meaning that ILECs must provide those UNEs to new entrants in *combined* form. Requiring ILECs to combine previously uncombined UNEs upon request is the "flip-side" of prohibiting them from separating already combined UNEs. In both instances, combined UNEs are being provided. There is no basis to say that the statutory provision is unambiguous in requiring new entrants to combine UNEs in one context, yet ambiguous enough to require ILECs to provide UNE combinations in the other.

The Eighth Circuit's holding also fails to give full effect to the statutory language. Section 251(c)(3) obligates ILECs to provide UNEs "in a manner that allows requesting carriers to combine such elements in order to provide [a] telecommunications service." 47 U.S.C. § 251(c)(3) (FCC Pet. App. 107a). The FCC correctly found that, in many instances, a requesting carrier would have no practical ability

to combine elements on an ILEC's network or could only do so through cumbersome and wasteful efforts. If the statutory language were read as narrowly as the Eighth Circuit suggests, the provision would be rendered a nullity, since requesting carriers would be effectively deprived of the ability to use combined UNEs "in order to provide a telecommunications service." The FCC properly determined that an ILEC's statutory duty to provide UNEs in the manner contemplated by Congress may require that the ILEC do the actual combining. As the FCC explained, Section 251(c)(3)'s language "means that incumbents must provide unbundled elements in a way that *enables* requesting carriers to combine them to provide a service[; it] does not impose the obligation of physically combining elements exclusively on requesting carriers." *Local Competition Order*, 11 F.C.C.R. at 15,647 (¶ 294) (FCC Pet. App. 46a).

C. It Was Reasonable For the FCC To Promulgate A Regulation That Prevents ILECs From Engaging In An "Anti-competitive Practice."

Because Section 251(c)(3) is ambiguous, the Eighth Circuit should have deferred to the FCC's expertise in implementing the provision's requirements. *Accord IUB I*, 525 U.S. at 395, 397. Rule 315(c)-(f) ensures that new competitors are not "seriously and unfairly inhibited in their ability to use unbundled network elements to enter local markets." *Local Competition Order*, 11 F.C.C.R. at 15,647 (¶ 293) (FCC Pet. App. 45a). The FCC determined that a new entrant might lack sufficient information about the ILEC's network to be able to perform the combinations at all. In particular, the FCC noted that "in practice it would be impossible for new entrants that lack facilities and information about the incumbent's network to combine unbundled elements from the incumbents' network without the assistance of the incumbent." *Id.*

These are the same types of competitive concerns that led this Court to reinstate Rule 315(b). The Eighth Circuit acknowledged that this Court's decision to reinstate Rule 315(b) "is rationally based on the nondiscrimination language in § 251(c)(3)," yet the Eighth Circuit never considered the potential for similar discriminatory or anticompetitive conduct as a reasonable justification for Rule 315(c)-(f). The only reason an ILEC would refuse to combine UNEs would be to impose unnecessary burdens and costs on new entrants. ILECs routinely combine UNEs and, because they control their networks, can do so much more efficiently than a new entrant. As long as the ILEC is fairly compensated for providing UNE combinations, there is no reason that new entrants—and ultimately their customers—should be forced to bear the additional costs, logistical delays, maintenance difficulties, and other burdens of attempting to combine elements on another carrier's network. These extra costs and delays, which ILECs do not suffer when serving their retail customers, would be pure economic waste borne exclusively by the new entrant, putting it at a substantial competitive disadvantage.

Recent developments illustrate the critical significance of Rule 315(c)-(f). The FCC has found that, in many contexts, "incumbent LECs have refused to provide access to network elements so that competitors could combine them." *In re Implementation of the Local Competition Provisions of the Telecomms. Act of 1996*, 15 F.C.C.R. 3696, 3910 (¶ 482) (1999). Thus, as a practical matter, new entrants cannot simply take uncombined elements within the ILEC's network and combine them themselves. Absent a requirement that the ILEC do the combining, competitors in many instances will not be able to use UNEs—the most promising of the Act's mechanisms for developing competition—to provide local service. Rule 315(c)-(f) should be restored.

CONCLUSION

For the foregoing reasons, Sprint respectfully requests that this Court reinstate 47 C.F.R. § 51.505(b)(1) and 47 C.F.R. § 51.315(c)-(f).

Respectfully submitted,

DAVID P. MURRAY
Counsel of Record
RANDY J. BRANITSKY
KEVIN M. MILLER
WILLKIE FARR & GALLAGHER
1155 21st Street, N.W.
Washington, D.C. 20036
(202) 328-8000

Counsel for Respondent Sprint Corporation